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# The Design and Sequencing of Trade and Investment Policy Reform

## An Institutional Analysis

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How different levels of political commitment and different degrees of organizational capability affect the design, sequence, and outcomes of trade and investment policy reform in twelve Bank-supported countries.

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This paper — a product of the Public Sector Management and Private Sector De elopment Division, Country Economics Department — is part of a larger effort in PRE to examine the institutional dimensions of economic reform and the way they influence the supply response of the private sector. Copies are available free from the World Bank, 1818 H Street NW, Washington DC 20433. Please contact Brian Levy, room N9-059, extension 37488 (33 pages with tables).

Adjustment faces political obstacles to the extent that it imposes costs on groups within society that are important to government or threatens the stability of a regime.

It faces organizational obstacles to the extent that it imposes tasks that government bureaucracies are incapable of meeting.

Political obstacles can undermine decisions about the extent of reform and efforts to implement reform. Organizational obstacles affect mostly implementation.

Levy argues that policy reform should be designed one way in countries with strong organizational capabilities but limited political flexibility and quite another way when the situation is reversed.

Organizationally strong but politically constrained countries should start with roundabout (indirect) but administratively intensive reforms as a way of building a constituency for subsequent liberalization — for example, promoting exports by setting up bonded export facilities and duty and tax drawback systems before trying to liberalize imports.

By contrast, countries with political flexibility but weak organizational capabilities — including many in Sub-Saharan Africa — should avoid roundabout measures. It is easier for them to dismantle poor regulations and interventionist institutions than it is to get them to stop constraining economic activity and start supporting it.

In politically flexible but organizationally weak countries, free entry should be favored over the establishment of one-stop shops to streamline bureaucratic requirements for new entrants; targeted investment incentives should be abolished rather than rewritten to favor socially efficient subsidization; and import liberalization should be pursued as much as possible, not finessed through support for exporters.

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## THE DESIGN AND SEQUENCING OF TRADE AND INVESTMENT POLICY REFORM: AN INSTITUTIONAL ANALYSIS

### I. INTRODUCTION

This paper analyzes from an institutional perspective the experiences of twelve countries with selected aspects of trade and investment policy reform. Over the past decade, financial support for these and other reforms has been central to the lending program of the World Bank. However, as is increasingly apparent,[1] the results of the reform efforts have been mixed: the gaps often are substantial between the policy implications of economic analysis and the policy reforms that are agreed upon with governments, between the reform commitments of governments and the reforms that are undertaken in practice, and between the expected and actual supply responses of reforming economies. This mixed record has focused attention on the design of reform packages -- on the appropriate mix of policies to be included in such packages, and on the appropriate sequence in which policy reforms should be introduced. The present paper analyzes the issue of the appropriate mix and sequence of trade and investment policy reform from an institutional perspective.

An institutional analysis highlights two distinct but related determinants of the appropriate design of policy reform -- the organizational capabilities of public bureaucracies, and the political flexibility of governments. As the analysis that follows will reveal, there exist significant variations among countries in their organizational capabilities and in their political commitments to change; policies also vary significantly in their organizational and political demands. It follows that the appropriate mix and sequence of policy reforms will be quite different for countries with strong political commitment to policy reform but relatively weak organizational capabilities than for countries with strong organizational capabilities but only limited political commitment to reform. The design of lending programs supported by the World Bank should respond to these differences among countries.

The next two sections of this paper lay out the analytical framework for an institutional analysis, and review from an institutional perspective the experience of twelve countries with selected aspects of trade and investment policy reform. The final section analyzes the reasons for the divergent patterns that are observed across countries and policies, and examines the implications of the analysis for lending by the World Bank for trade and investment policy reform.

### II. A FRAMEWORK FOR ANALYSIS

A central objective of this paper is to analyze concretely how lending programs for trade and investment policy reform might be adapted to an individual country's organizational capabilities and political commitment to policy reform. The starting point for analysis must thus be the distinction between organizational and political obstacles to reform.

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[1] For an overview, see "Adjustment Lending: An Evaluation of Ten Years of Experience" Policy and Research Series 1, Country Economics Department, The World Bank.

Organizational and political obstacles can be differentiated in two complementary ways -- by focusing on the character of the obstacles themselves, and by focusing on the point in the policy process at which each obstacle has its impact. To begin with the character of the obstacle, adjustment faces political obstacles insofar as it imposes costs on groups within society --perhaps private actors, perhaps the government bureaucracy itself -- that are important to government, or more broadly threatens regime stability; adjustment faces organizational obstacles insofar as it imposes tasks on government bureaucracy which that bureaucracy lacks the capability to meet. As for the relation between obstacles and the policy process, the key distinction here is whether the obstacles influence the reform decisions of government or whether, subsequent to the decisions, they influence the way in which the reform program is implemented.[2]

It is plausible to hypothesize that political obstacles can both influence decisions about the extent of reform and can undermine efforts to implement proclaimed reforms. By contrast, organizational obstacles emerge disproportionately in implementation. This distinction between limitations in the extent of reforms countries decide to pursue, and limitations in subsequent implementation should, therefore, offer useful insights as to the relative importance of political and organizational obstacles in inhibiting efforts at reform.

One additional distinction is useful in analyzing the impact of policy lending by the World Bank. Policy lending generally is based on agreements[3] between the World Bank and the borrowing country as to the specific content of the reforms that will be undertaken. However, these agreements usually are concluded before adoption by the borrowing country of the proposed reforms; sometimes, agreements with the World Bank notwithstanding, reforms are not adopted.

To incorporate this last distinction, this paper examines three interrelated dimensions of country experiences with policy reform: scope, adoption, and implementation. Program scope is defined by the extent of the proposed reforms in trade and investment policy and practices in relation to the gap at the outset of reform between policies in place and the putative policy regime of a fully-liberalized economy. The scope of a country's reform program is ranked ordinally as limited, moderate, extensive, or very extensive. Note that scope is ranked according to how far an individual country has travelled along the path from its specific starting point to a fully-liberal economy, not according to how distorted the economy was initially, nor

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[2] This sharp distinction between policy decisions and policy implementation is consistent with the blueprint approach to policymaking generally followed by the World Bank but criticized sharply for the inflexible way in which it limits feedback from implementation to policy design by, among others, David Korten in, for example, "Community Organization and Rural Development: A Learning Process Approach", <u>Public Administration Review</u> 40, September 1980, pp. 488-511. As the critics acknowledge, policies and projects vary in the extent to which they can be designed adequately up-front. The policies analyzed in this paper are those where the scope for pre-planning is substantial and the associated necessity of fluid design thus relatively limited.

[3] These agreements often -- but not always -- are incorporated in formal conditions attached to World Bank loans. The present paper makes no attempt to differentiate proposed reforms on the basis of whether or not they were included in formal conditions.

how distorted it remains at the end (as of the time of writing this paper) of the reform process, nor according to the absolute magnitude of policy change. Program adoption refers to the step whereby a government proceeds from agreements made with the World Bank to official public pronouncements in its home country that it intends to proceed with those commitments. Program implementation refers to the extent to which announced reforms indeed were carried out in practice. The categories used to rank both adoption and implementation are limited progress, significant progress, and achieved. Adoption is ranked in relation to proposed scope; implementation is ranked in relation to what was actually adopted. The ordinal judgements as to variations among countries in the scope, adoption and implementation of reforms necessarily include some subjective element.

## III. COUNTRY EXPERIENCE WITH TRADE AND INVESTMENT POLICY REFORM

The central objectives of trade and investment policy reform are to improve allocative and productive efficiency -- to put in place a set of relative prices that increases the economic efficiency with which countries allocate their resources, and to increase the competitive pressure on enterprises as a way of inducing firms progressively to increase their productivity. Three complementary policy reforms have been identified to achieve these objectives -- the promotion of import competition, the promotion of domestic competition, and the promotion of production for exports.[4]

An institutional analysis of the full range of policy reforms in each of the three areas of competition policy is beyond the scope of the present paper; rather, the paper analyzes country experiences with selected policies within each area. Twelve countries were chosen non-randomly for inclusion in the study to illustrate the diversity of country and World Bank experience. Table 1 details the policy-based loans made by the World Bank in the 1980s that addressed trade and investment policy issues in these countries. The next three subsections delineate from an institutional perspective country experiences with selected policy reforms to promote import competition, domestic competition, and production for exports.

### The Promotion of Import Competition

Within the larger set of policies that promote import competition, the paper reviews from an institutional perspective efforts to eliminate quantitative restriction and to move towards a low and uniform tariff structure.[5]

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[4] For a review of each of these areas of policy reform, see Claudio Frischtak, "Competition Policies for Industrializing Countries", Industry Development Division, PPR, The World Bank, March 10, 1989.

[5] Additional policies relevant to import liberalization that might usefully be reviewed from an institutional perspective but were beyond the scope of this paper include efforts to unify exchange rates, and to allocate foreign exchange according to market rather than administrative criteria.

**TABLE 1: LENDING BY THE WORLD BANK FOR TRADE AND INVESTMENT POLICY REFORM IN TWELVE COUNTRIES**

| COUNTRY | YEAR | LOANS/CREDITS TOWARDS TRADE AND INDUSTRIAL PROJECTS | AMOUNT ($ million) |
|---|---|---|---|
| Bangladesh | 1987 | Industrial Sector Credit | 190.0 |
| | 1989 | Export Development Project | 25.0 |
| Ghana | 1984 | Export Rehabilitation | 75.9 |
| | 1986 | Industrial Sector Adjustment | 53.5 |
| | 1987 | Structural Adjustment Program | 34.0 |
| | 1989 | Second Phase of Structural Adjustment Program | 120.0 |
| Guinea | 1982 | Industrial Rehabilitation & Promotion | 19.0 |
| | 1986 | Structural Adjustment I | 42.0 |
| | 1988 | Structural Adjustment I | 65.0 |
| Jamaica | 1981 | Export Development Fund II | 37.0 |
| | 1982 | Structural Adjustment I | 76.2 |
| | 1982 | Kingston Export Free Zone | 13.5 |
| | 1983 | Export Development Fund III | 30.1 |
| | 1983 | Industrial Credit | 15.1 |
| | 1984 | Structural Adjustment II | 60.2 |
| | 1986 | Structural Adjustment III | 55.0 |
| | 1987 | Trade and Finance Sector Adjustment | 40.0 |
| Kenya | 1980 | Export Promotion T.A. | 4.5 |
| | 1980 | Structural Adjustment I | 55.0 |
| | 1982 | Structural Adjustment II | 130.9 |
| | 1988 | Industrial Sector Adjustment | 165.7 |
| Mauritius | 1981 | Structural Adjustment I | 15.0 |
| | 1983 | Structural Adjustment II | 40.0 |
| | 1987 | Industrial Sector Adjustment | 25.0 |
| | 1988 | Industrial Finance Project | 10.0 |
| Mexico | 1983 | Export Development | 350.0 |
| | 1986 | Industrial Recovery | 150.0 |
| | 1986 | Trade Policy Loan | 500.0 |
| | 1987 | Export Development II | 250.0 |
| | 1987 | Second Trade Policy Loan | 500.0 |
| | 1987 | Small & Medium Scale Industry IV | 270.0 |
| | 1989 | Industrial Restructuring | 250.0 |
| | 1989 | Industry Sector Policy | 500.0 |

| COUNTRY | YEAR | LOANS/CREDITS TOWARDS TRADE AND INDUSTRIAL PROJECTS | AMOUNT ($ million) |
|---|---|---|---|
| Morocco | 1984 | Industrial Trade and Policy Adjustment I | 150.4 |
| | 1985 | Industrial Trade and Policy Adjustment II | 200.0 |
| | 1987 | Industrial Export Finance | 70.0 |
| | 1988 | Structural Adjustment I | 200.0 |
| Pakistan | 1982 | Structural Adjustment Loan | 60.0 |
| | 1985 | Industrial Investment Credit II | 148.0 |
| | 1986 | Export Development | 70.0 |
| | 1988 | Agricultural Sector Adjustment | 200.0 |
| | 1989 | Industrial Investment Credit III | 148.0 |
| | 1989 | Financial Sector Adjustment | 150.0 |
| Philippines | 1980 | Structural Adjustment I | 200.0 |
| | 1983 | Structural Adjustment II | 302.3 |
| | 1987 | Economic Recovery | 300.0 |
| | 1989 | Financial Sector Adjustment | 300.0 |
| Thailand | 1982 | Structural Adjustment Loan | 150.0 |
| | 1983 | Structural Adjustment II | 175.5 |
| Tunisia | 1985 | Export Industries | 72.4 |
| | 1987 | Industry and Trade Policy Adjustment | 150.0 |
| | 1988 | Small & Medium Scale Industrial Dev. II | 28.0 |
| | 1988 | Structural Adjustment | 150.0 |
| | 1989 | Public Enterprise Reform | 130.0 |

Eliminating quantitative restrictions. Table 2 summarizes the experience with reform of quantitative restrictions in twelve countries (with two separate entries for the Philippines). On the basis of the judgements summarized in the table, the countries can be categorized into four distinct groups.

The first group comprises Bangladesh and the Philippines (since Corazon Aquino became president). In both countries, QR protection was substantial, but the scope of reform agreed upon in negotiation with the World Bank was moderate; the countries declared their intentions to reduce somewhat the range of imports subject to QRs, but via ad hoc incremental procedures. Both countries appear to have moved ahead with the adoption and implementation of these moderate reforms.

The second group comprises Kenya (prior to 1988), the Philippines (during the Marcos era), Pakistan, and Tunisia, all also heavily QR protected prior to reform. In negotiations with the World Bank, these countries proposed reforms of QRs that were more extensive than those of the first group. In both Kenya and the Philippines, QR liberalization was aborted in the wake of balance of payments crises. But even before these crises, there was evidence that political opposition would limit program adoption; and for four years after the crisis had passed there was little effort in Kenya to resume liberalization. Pakistan reduced QRs incrementally throughout the 1980s, but the reform process has been very uneven; in mid-1987, for example, the government banned imports of some items at the same time as it eased quantitative restrictions on others.[6] As for Tunisia, that country's government was quite explicit that its hesitations in following through with its initial intentions (intentions not reflected in markedly more modest formal conditions) were rooted in fear of the political consequences of the plant closures and associated unemployment it expected to follow from liberalization of QRs.[7]

The third group comprises Ghana, Jamaica, Mexico, Morocco, Mauritius and Thailand. All six countries achieved far-reaching success in the elimination of QRs -- although the extent to which these successes imply genuine reductions in import protection depends also upon parallel changes in import tariff policies.[8] Ghana, Jamaica, Mexico and Morocco began their reform efforts with near-universal QRs on imports; as of mid-1989, QRs had been eliminated entirely in Ghana, almost entirely in Jamaica, afforded protection for only 14% of total import value (but 40% of local production) in Morocco, and for 22% of local production in Mexico. Especially in Mexico, the political obstacles to QR reform appear to have been substantial.

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[6] The World Bank, Pakistan: Growth Through Adjustment, Report Number 7118-Pak, March 21, 1988, pp. 64-72; also The World Bank, Pakistan: Medium-Term Economic Policy Adjustments, Report Number 7591-PAK, March 17, 1989.

[7] Tunisian government officials communicated these fears to World Bank staff in the course of a recent review of the country's industrial sector.

[8] As reviewed below, Mexico, Morocco and Ghana also made significant progress in tariff reform; but tariff reform has proceeded slowly in Mauritius, Thailand and (until recently) Jamaica.

**TABLE 2: COUNTRY EXPERIENCES WITH REMOVAL OF QUANTITATIVE RESTRICTIONS**

| GROUPS/COUNTRIES | SCOPE | ADOPTION | IMPLEMENTATION OF ADOPTED REFORM |
|---|---|---|---|
| Group 1: Moderate reform, adopted and implemented | | | |
| Bangladesh | Moderate | Achieved | Achieved |
| Philippines (under Aquino) | Moderate | Achieved | Achieved |
| Group 2: Problems with adoption | | | |
| Kenya (prior to 1988) | Extensive | Limited Progress | Achieved |
| Philippines (under Marcos) | Extensive | Limited Progress | Achieved |
| Pakistan | Moderate | Significant Progress | Achieved |
| Tunisia | Extensive | Limited Progress | Achieved |
| Group 3: Extensive reform, adopted and implemented | | | |
| Mexico | Very Extensive | Achieved | Achieved |
| Ghana | Very Extensive | Achieved | Achieved |
| Thailand | Very Extensive | Achieved | Achieved |
| Mauritius | Very Extensive | Achieved | Achieved |
| Morocco | Extensive | Achieved | Achieved |
| Jamaica | Very Extensive | Achieved | Achieved |
| Group 4: Implementation problems | | | |
| Guinea | Very Extensive | Achieved | Significant Progress |
| Kenya (Since 1988) | Moderate | Significant Progress | Significant Progress |

Between 1985 and 1988, the Mexican Ministry of Trade and Industry (SECOFI) sought at each stage to undercut efforts to eliminate QRs: the same day as the Ministry of Finance (which controlled import licenses) announced its first reduction of QRs, SECOFI trebled the reference prices against which tariffs were calculated; subsequently it made recourse to anti-dumping procedures as a protective device. But, consistent with the clear commitment to dismantling QRs at the highest reaches of the Mexican government, both obstacles to import liberalization were removed quite speedily.[9] As for Mauritius and Thailand, in neither country had QRs been an important instrument of protection, although in both its use was rising prior to policy reform. The reform programs of both countries were successful in eliminating entirely the use of QRs.

Only Guinea and Kenya (since 1988), the countries in the fourth group ran into some difficulties with implementation. In Kenya, implementation was slowed somewhat by administrative difficulties in making the transition from one relatively complex schedule of QR restrictions to another; additionally, Kenya failed to adopt QR liberalization for some products that were initially to be included in the reform.[10] Notwithstanding a 1987 decision in Guinea to abolish what had been a near-universal system of import licensing, as of early 1989 the Guinean Central Bank continued to exercise some administrative discretion in allocating foreign exchange for imports; additionally, there were isolated instances where privatization of state-owned enterprises was accompanied by restrictions on imports in the affected industry.[11] Overall, though, in both Guinea and Kenya (post-1988) progress has been significant in following through on their respective (and quite different in scope) reforms.

Reforming the structure of tariffs. Prior to the initiation of reform efforts, tariff regimes were inefficient in all twelve countries, with high average nominal tariffs, high standard deviations, and the familiar cascading structure. Table 3 breaks down the countries subsequent experiences with tariff reform into three groups.

The first group comprises two countries -- Kenya and Mauritius -- which committed themselves to relatively limited reforms but followed through successfully on these commitments. Kenya has painstakingly made its tariff schedule somewhat more uniform over almost a decade, with the intention of accelerating the process once QR liberalization is completed. Prior to 1987 Mauritius made little effort to reform tariffs, even as it moved ahead rapidly with efforts at export promotion (on which more later); in 1987 it adopted -- and apparently has followed through with -- a somewhat more ambitious program of tariff liberalization.

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[9] Information from an interview with a World Bank official involved in lending to Mexico during the relevant period.

[10] "Aide Memoire", World Bank Supervision Mission, Industrial Sector Adjustment Credit, March 1-17, 1989.

[11] This and other details of implementation difficulties in Guinea are from World Bank, "Private Sector Promotion Adjustment Operation: Draft Initiating Memorandum", May 1989, and from interviews with World Bank officials active in Guinea.

## TABLE 3: COUNTRY EXPERIENCES WITH TARIFF REFORM

| GROUPS/COUNTRIES | SCOPE | ADOPTION | IMPLEMENTATION OF ADOPTED REFORM |
|---|---|---|---|
| **Group 1: Moderate reforms, adopted and implemented** | | | |
| Kenya | Moderate | Achieved | Achieved |
| Mauritius | Moderate | Achieved | Achieved |
| **Group 2: Problems with adoption** | | | |
| Bangladesh | Moderate | Significant Progress | Achieved |
| Morocco | Extensive | Significant Progress | Achieved |
| Pakistan | Moderate | Significant Progress | Achieved |
| Thailand | Extensive | Limited Progress | Achieved |
| **Group 3: Extensive reforms, adopted and implemented** | | | |
| Ghana | Extensive | Achieved | Achieved |
| Mexico | Very Extensive | Achieved | Achieved |
| Philippines | Extensive | Achieved | Achieved |
| Tunisia | Very Extensive | Achieved | Achieved |
| Jamaica | Extensive | Too soon to tell | Too soon to tell |
| **Group 4: Extensive reform, implementation problems** | | | |
| Guinea | Very Extensive | Achieved | Limited Progress |

The second group comprises Thailand, Morocco, Bangladesh and Pakistan. All four countries ran into obstacles as they endeavored to adopt their tariff reforms. In Thailand, adoption w· inhibited by the consensual character of Thai decision-making and a relatedunwillingness to face down opposition by those private industrialists that stood to lose from tariff liberalization. Consequently (perhaps buttressed by fiscal considerations), moves to liberalize tariffs repeatedly were offset by countervailing increases; although the reforms did succeed in imposing a 60% ceiling on nominal tariffs, there has been little change in the level and dispersion of effective protection.[12] Morocco's reform program also was slowed by an unwillingness (apparently for both fiscal and political reasons) to reduce some tariffs to the extent initially planned; even so, by mid-1989 both the level and dispersion of tariffs had narrowed significantly. Bangladesh's goals were modest, and its achievements yet more limited: the country successfully rationalized tariffs in some targeted sectors, but failed to follow through with its initial intention to impose a 100% nominal tariff ceiling on all imported items. As for Pakistan, although the scope of proposed tariff reforms was modest prior to 1988, the country failed to follow through with what it did proclaim, with ad hoc increases in some tariffs, and ad hoc reduction in others; a new, somewhat more ambitious round of tariff reforms initiated in mid-1988 appears to hold the promise of achieving more uniformity in the tariff structure over time.

The third group comprises five countries -- Mexico, Tunisia, the Philippines, Ghana and Jamaica. The first four of these countries agreed on extensive or very extensive programs to move towards low and uniform tariffs in negotiations with the World Bank, and adopted and implemented essentially their entire program -- although the extent to which these successes imply genuine reductions in import protection depends also on parallel changes in QR policies.[13] As for Jamaica, in the course of three SALs between 1982 and 1986 little effort was made to narrow the band of tariffs or to eliminate the large number of ad hoc exemptions from tariff payments granted to firms. Indeed, between 1982 and 1986 tariff protection actually increased somewhat with the imposition of stamp duties and reference prices subsequent to the relaxation of QRs. A more serious, phased effort at tariff reform was initiated in 1987. Adoption and implementation of the initial measures apparently has proceeded quite smoothly, while the latter phases have not yet been undertaken.

Guinea was the only representative of a fourth group of countries where a very extensive program was obstructed by difficulties in implementation: a uniform tariff code adopted in 1986 was undermined by tariff exemptions negotiated with firms on an ad hoc basis by individual ministries; and Guinean customs operated almost as an independent fiefdom, with payoffs apparently crucial in decisions as to whether or not to reject tariff exemptions agreed upon by individual ministries, and in the degree to which onerous documentary requirements blocked clearance of imported goods.

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[12]. See The World Bank, <u>Thailand: Building on the Recent Success</u>, Report No-7445-TH, February 21, 1989, pp. 58-60; also <u>Thailand: Growth with Stability</u>, Report No-6036-TH, June 5, 1986 p. 147. There is no evidence that the somewhat chaotic organization of Thailand's tariff review process (highlighted in the 1986 report, pp. 155-157) contributed to the imposition of broad-ranging counterveiling measures subseqent to each effort at tariff liberalization.

[13] As reviewed earlier, Mexico, Ghana and Jamaica made substantial -- but Tunisia limited, and the Philippines moderate -- progress in their reforms of QRs.

Some patterns. Two patterns evident in the above review will be important in the analysis in the final section of this paper. First, limitations in organizational capability do not appear to represent a significant obstacle to import liberalization; only in Guinea and Kenya -- and (Guinea's tariff reform aside) only to a limited extent -- did difficulties in implementation hinder the elimination of QRs and the reform of tariffs. Second, political obstacles to import liberalization (which, as noted earlier, are disproportionately likely to manifest themselves via limitations in scope or adoption) appear to be rather more substantial.[14] Scope or adoption was limited or moderate for six of the twelve countries for QR liberalization, and for five of the twelve countries for tariff reform.[15] Only Mexico, Morocco and Ghana[16] unambiguously achieved significant reductions in import protection via extensive reforms of both QR and tariff policies.

The Promotion of Domestic Competition

Within the larger set of policies that promote domestic competition, the paper reviews from an institutional perspective efforts to eliminate direct regulatory impediments to entry and to reform investment incentives.[17]

Eliminating regulatory obstacles to entry. The focus here is on direct bureaucratic impediments to entry by new firms (registration and licensing prerequisites, entry and investment approvals and the like); the myriad of indirect impediments such as labor laws, building codes, and financing impediments thus fall outside the scope of the present analysis. Table 4 reviews country progress in eliminating these direct regulatory obstacles to entry for domestic firms.[18]

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[14] The World Bank, "Strengthening Trade Policy Reform", Trade Policy Division, Country Economics Department, PPR, October 1989, summarizes in some detail the character of the political obstacles that inhibit import liberalization.

[15] Interestingly, none of the twelve countries followed the sequence that is sometimes recommended of increasing tariffs as a way of smoothing the process of liberalizing QRs on imports; note though that QR liberalization preceded subsequent tariff reform in Morocco and Jamaica, while import reforms in Mauritius and Thailand could plausibly be interpreted as in process, with the initial steps now completed.

[16] The Philippines and Jamaica might plausibly be added to this list -- the former if (rather than break down the import liberalization experience into two distinct periods) the magnitude of change is calibrated over the decade between 1979 and 1989, the latter insofar as the 1987 tariff reforms have indeed been successfully adopted and implemented.

[17] Additional policies relevant to the promotion of domestic competition that might usefully be reviewed from an institutional perspective but were beyond the scope of this paper include the regulation of monopolistic practices, price controls and the regulation of trading, and the organization of financial intermediation.

[18] The regulation of foreign investment is not analyzed in the present paper.

**TABLE 4: COUNTRY EXPERIENCES WITH REFORM OF ENTRY REGULATIONS**

| GROUPS/COUNTRIES | SCOPE | ADOPTION | IMPLEMENTATION OF ADOPTED REFORM |
|---|---|---|---|
| Group 1: Moderate reforms | | | |
| Ghana | Limited | Achieved | Limited progress |
| Kenya | Moderate | Too Soon To Tell | Too Soon To Tell |
| Mexico | Limited | Too Soon To Tell | Too Soon To Tell |
| Jamaica | Unaddressed | - | - |
| Group 2: Extensive reforms, adopted and implemented | | | |
| Pakistan | Extensive | Achieved | Achieved |
| Bangladesh | Extensive | Achieved | Achieved |
| Tunisia | Very Extensive | Achieved | Achieved |
| Thailand | Unaddressed | - | - |
| Morocco | Unaddressed | - | - |
| Mauritius | Unaddressed | - | - |
| Philippines | Unaddressed | - | - |
| Group 3: Extensive reforms, implementation problems | | | |
| Guinea | Very Extensive | Achieved | Limited progress |

In the first group identified in the table -- Ghana, Jamaica, Kenya, and Mexico -- the scope of entry reform has been modest. Prior to 1989, Mexico made little effort to ease the nation's substantial bureaucratic obstacles to entry, although there are indications that the country is about to embark[19] on a far-reaching effort in this area. Both Kenya and Ghana have endeavored to put in place 'one-stop shops' to ease the bureaucratic hurdles for putative entrants. While the verdict is still out on the Kenyan experience, so far implementation has been weak in Ghana: new investments remain subject to requirements of prior approval; despite some efforts at streamlining, the approval procedures of Ghana's National Investment Commission remain time-consuming and cumbersome. As for Jamaica, the reduction of bureaucratic obstacles to entry -- although they apparently are quite substantial[20] -- has not yet found its way onto the reform agenda.

In the second group of countries -- comprising Bangladesh, Pakistan, Tunisia and Guinea-- significant efforts were made to ease direct bureaucratic obstacles to entry. [Thailand, Morocco,[21] Mauritius and the Philippines[22] permitted free entry prior to the initiation of the reform process; hence the absence in those countries of any reform measures in this area.] In Tunisia, clearance requirements for putative new entrants were abolished entirely; in Bangladesh a negative list was established, with free entry permitted for all but explicitly restricted sectors and other investments in excess of a (relatively large) minimum size; in Pakistan, the investment ceiling above which clearance for new entrants was required was increased from Rs60 million in 1984 to Rs 500 million in 1988. No evidence was uncovered in Tunisia, Bangladesh or Pakistan of difficulties in either adoption or implementation, although it should be noted that at least in Tunisia even after the reform of entry regulations other obstacles continued to inhibit entry by new firms. By contrast, in Guinea (the only country in the third group) reforms that were very extensive in scope were undermined by severe problems of implementation.

It is instructive to contrast the Tunisian and Guinean experience in eliminating direct bureaucratic obstacles to entry. Subsequent to Guinea's 1987 reforms, most firms formally were free to establish themselves by the routine act of incorporation at the Trade Registry. In practice as of early 1989, incorporation procedures continued to be onerous and time consuming; individual ministries continued to require prior approval for all investments falling in their domain of responsibility; and the Ministry of Commerce and Industry continued to require

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[19] In a first move, a sweeping deregulation of the hitherto monopolistic Mexican trucking industry went into effect in September 1989.

[20] See, The World Bank Jamaica: Adjustment Under Changing Economic Conditions, Report No. 7753-JM, April 26, 1989, p. 39

[21] In practice, difficulties with land titles, with the issuance of construction permits and in obtaining access to finance represented real impediments to entry by Moroccan firms. See The World Bank, Morocco: The Impact of Liberalization, Report No. 6714-MOR, March 15, 1988 p. 59.

[22] Philippine firms that failed to register with the Board of Investments both were excluded from investment incentives (discussed in the next section) and were denied access to foreign exchange. Some efforts apparently were made to open access to foreign exchange to both registered and unregistered firms, but no information is available as to subsequent experience.

that all firms be licensed for trading. Like Guinea, Tunisian reforms formally freed firms from the requirement that they obtain official approval prior to entry. But unlike Guinea the elimination of direct regulatory obstacles to entry appears to have been fully implemented. While the Agence de Promotion des Investissements (API) -- which had hitherto been responsible for regulating entry, along with approving investment incentives (on which more below) and generally promoting industry -- continues to operate, a recent World Bank mission uncovered no evidence that API approval was any longer required by putative entrants. Bereft of their regulatory function, the agency's staff of 550 apparently occupied themselves with rather vaguely defined 'studies'. Whether the agency will attempt to fill its present vacuum of inactivity with renewed efforts at regulation remains to be seen. So far, however, that has not happened.[23]

Reforming investment incentives. At the outset of reform, incentive schedules in all of the sample countries discriminated among categories of investments in ways that had little economic rationale. In principle, liberal reform might either eliminate all preferential subsidies, or target subsidies in a transparent and efficient way to a limited number of activities to compensate for unambiguous market failures.[24]

As Table 5 summarizes, in Kenya, Pakistan and Jamaica[25] reforms of investment incentives were entirely unaddressed in adjustment lending. In Bangladesh, Morocco and Thailand, the scope of reforms was relatively modest. Morocco agreed in 1988 to reduce the duration and rate of exemptions granted to enterprises through its Investment Code; Bangladesh created a Board of Investment in 1989. Reform of investment incentives has been on the agenda of policy dialogue between the World Bank and Government of Thailand since the early 1980s, but has been painstakingly slow. Explicit, increasingly detailed criteria for the provision of incentives were promulgated by Thailand's Board of Investment in 1983 and again 1987, and efforts have been made since 1985 to streamline the procedures for processing applications. But the criteria of eligibility remain too broad to provide much guidance to potential investors.[26]

Four countries -- Tunisia (in 1987), Ghana (in 1985), Guinea (in 1984 and again in 1987) and the Philippines (in 1983 and again in 1987) -- moved more broadly to streamline and make economically more efficient their incentive packages. While there was no evidence in any of these countries of a gap between the scope of investment reforms and subsequent adoption, there was substantial evidence of difficulties with implementation.

[23] API's current role was examined in some detail during a June 1989 World Bank mission to survey Tunisia's industrial sector.

[24] Incentives intended to secure trade neutrality for exporters will be analyzed later in this paper.

[25] In Jamaica, investment incentives often took the form of duty-free access to capital goods and intermediate inputs for favored import-substituting firms; reforms in these incentives were noted earlier in the context of trade policy reform. Additional efforts at reforming investment incentives took on the narrowly institutional form of amalgamating into a single agency the three main bureaucracies with responsibility for the industrial sector.

[26] For this judgement, see The World Bank Thailand: Building on the Recent Success, Report No. 7445-TH, February 21, 1989, p. 67.

**TABLE 5: COUNTRY EXPERIENCES WITH REFORM OF INVESTMENT INCENTIVES**

| | SCOPE | ADOPTION | IMPLEMENTATION OF ADOPTED REFORM |
|---|---|---|---|
| **Group 1: No more than moderate reforms** | | | |
| Bangladesh | Limited | Too soon to tell | Too soon to tell |
| Morocco | Moderate | Too soon to tell | Too soon to tell |
| Thailand | Moderate | Limited Progress | Significant Progress |
| Kenya | Unaddressed | - | - |
| Jamaica | Unaddressed | - | - |
| Pakistan | Unaddressed | - | - |
| **Group 2: Extensive reforms, implementation problems** | | | |
| Tunisia | Extensive | Achieved | Significant Progress |
| Guinea | Extensive | Achieved | Limited progress |
| Philippines (under Marcos) | Extensive | Achieved | Limited progress |
| Philippines (under Aquino) | Extensive | Achieved | Too soon to tell |
| Ghana | Moderate | Achieved | Limited Progress |
| **Group 3: Very extensive reforms, adopted and implemented** | | | |
| Mauritius | Very extensive | Achieved | Achieved |
| Mexico | Very extensive | Achieved | Achieved |

Notwithstanding simplification of the Tunisian Investment Code, the criteria for eligibility remained complex and obscure to most businessmen. The Philippines under Marcos was notorious for favoring political clients in the allocation of incentives even after the adoption in 1983 of extensive reforms of the system of investment incentives.[27] Incentives were reformed again under President Aquino in 1987, but it is too soon to tell[28] what will be the effectiveness of the new round of reforms. In both Ghana and Guinea, approval procedures continue to be lengthy, decisions on occasion remain arbitrary, and there continues to be overlapping ministerial jurisdiction; in Guinea, notwithstanding the formal authority of the National Investment Commission to negotiate incentives, individual ministries continue to negotiate incentives packages, including various duty and tax exemptions, with firms on a case-by-case basis.

By contrast with the experience of countries that endeavored to simplify their codes, two countries -- Mexico and Mauritius -- essentially eliminated preferential incentives for selected investments. In 1987 Mexico eliminated almost entirely the CEPROFI package of tax incentives which had been the dominant vehicle for subsidizing investments in the country; similarly, that same year Mauritius agreed with the World Bank to discontinue its practice of granting Development Certificates for favored import substitution projects for all but exceptional cases,[29]. By all accounts, the abolition of these incentives has proceeded smoothly in both countries.

Some patterns. Again, it is helpful to set the stage for analysis in the final section of this paper by highlighting some patterns evident in the review of policy reforms to promote domestic competition. First, problems with implementation appear to be related to the way in which specific policies are formulated: putting in place 'one-stop shops' to ease the bureaucratic hurdles for putative entrants seems to be organizationally more difficult to achieve than does abolishing entry prerequisites; similarly, problems of implementation appear to be more substantial where investment incentives are streamlined than where they are abolished. Second, there appear to be significant variations among countries in the scope and adoption of reforms to promote domestic competition: while some countries (Tunisia and Guinea)[30] adopted extensive reforms both to eliminate regulatory prerequisites to entry and to reform investment incentives, others (Ghana and Kenya) made no serious reform efforts in either area; and some

[27] For an extended analysis of the political economy of Philippine cronyism, see Stephan Haggard, "The Political Economy of the Philippine Debt Crisis", in Joan Nelson (ed.) Economic Crisis and Policy Choice (Princeton: Princeton U. Press, forthcoming 1989).

[28] For this judgement, see The World Bank, Philippines: Fourth Small and Medium Industries Development Project, Report number 7531-PH, March 15, 1989, p. 4.

[29] The criteria stated by the Government of Mauritius for these 'exceptional cases' in its 1987 statement of industrial policy remain quite general. In practice, the granting of development certificates fell into abeyance even prior to 1987, with 12 certificates granted in fiscal year 1984, 3 in fiscal year 1985, and none in 1986.

[30] Mauritius and the Philippines might be included in this group insofar as both countries made extensive reforms of investment incentives, while entry apparently was liberalized at the outset of the reform efforts.

countries (Pakistan and Bangladesh) made substantial advances in easing regulatory obstacles to entry but not in reforming investment incentives, while others (Mexico) reformed investment incentives but not entry prerequisites. Third, there appear to be significant variations among countries in the extent of difficulties with implementation; for Ghana and Guinea in particular, organizational obstacles to reforming the environment for domestic competition appear to have been substantial.

The Promotion of Export Production

Within the larger set of policies that promote export production, the paper reviews from an institutional perspective efforts to put in place administrative instruments intended to secure 'trade neutrality'[31] for exporters -- that is, to secure access to imported (or local) inputs free of import duties or other indirect taxes.[32]

As was evident from the earlier review of import liberalization, and as Table 6 summarizes, not one of the twelve countries in the sample has moved to an entirely liberal import regime with no quantitative restrictions and low and uniform tariffs. Import liberalization appears to have proceeded furthest in Ghana, Morocco and Mexico; but even in these countries some imports continue to be subject to quantitative restrictions, and others subject to nominal tariffs in excess of 50%. The combination of high-cost, low quality locally-produced inputs, and imported inputs either unavailable or subject to high tariffs inhibits the ability of putative exporters to compete in international markets.

[31] The phrase is from Yung Whee Rhee, "Instruments for Export Policy and Administration: Lessons from the East Asian Experience", World Bank Staff Working Papers Number 725, 1985.

[32] Additional policies to promote exports that might usefully be reviewed from a institutional perspective but were beyond the scope of this paper include direct export subsidies and their administration, mechanisms to secure access to working capital for exporters, and various arrangements to provide technical and marketing support for potential exporting firms. Rhee "Instruments for Export Policy" provides substantial detail on the appropriate organization of mechanisms to secure access to working capital. Three papers by Don Keesing -- "How to Provide High Impact Assistance to Manufactured Exports from Developing Countries", (with Andrew Singer) The World Bank, Trade Policy Division, PPR, mimeo, September 1989; "What Goes Wrong in Official Promotion and Marketing Assistance for Manufactured Exports from Developing Countries" (with Andrew Singer) The World Bank, Trade Policy Division, PPR, mimeo, September 1989; and "The Four Successful Exceptions", UNDP-World Bank Trade Expansion Program Occassional Paper 2, September 1988 -- provide rich, institutionally sensitive analysis of the design of technical and marketing support.

**TABLE 6: PROGRESS OF TRADE POLICY REFORM IN THE SAMPLE COUNTRIES**

| COUNTRY /a | Imports subject to Quantitative Restrictions | Range of Nominal Tariffs | Range of Effective Tariffs |
|---|---|---|---|
| Bangladesh (1987) | 27% of all items | 0 - 400% | 2.5 - 200% |
| Ghana (1989) | QRs essentially removed | 0 - 35% | 25 - 90% |
| Guinea (1988) | QRs formally removed | 10 - 50% | no information |
| Kenya (1987) | 55% of all items<br>18% of import value | no information past 1985 | 0 - 80% for 60% of imports |
| Jamaica (1988) | 11% of all items | 10 - 60% | <10> - 75% (manufacturing) |
| Mauritius (1987) | QRs removed | 0 - 450% | <24> - 800% |
| Mexico (1989) | 22% of local production | 0 - 20% | 0 - 50% |
| Morocco (1989) | 11% of items, 14% of import value | 0 - 45% | 11 - 180% |
| Pakistan (1989) | 34% of all items | 0 - 225% | 0 - 80% for 50% of all goods |
| Philippines (1987) | 34% of all items; 16.4% of import value | 10 - 50% | 18 - 144% |
| Thailand (1988) | QRs removed | 0 - 60% | 10 - 100% |
| Tunisia (1988) | 70 - 90% of local production | 15 - 41% | no information |

Note: /a. Year cited represents last obtainable data, not date of reports referenced.

Further, as noted earlier, the persistence of import protection among even the boldest reformers points to governmental inability or unwillingness to confront head-on some political obstacles to full liberalization;[33] endless exhortation (necessary as it may be) as to the virtues of full liberalization is likely to be limited in its impact. Given these constraints, the short-run task for policy reform is to find ways to encourage exports while finessing political obstacles; the long-run task is to help strengthen a constituency which would gain from further liberal reform. Putting in place instruments to secure trade neutrality is one way to move forward with these tasks.

Table 7 disaggregates among the various instruments designed to secure trade neutrality that have been put in place by ten of the twelve countries[34] in the sample. Provisions for firms to draw back customs duties and indirect taxes paid on imported inputs used in exports are used most widely (in ten of the twelve countries), followed by arrangements where firms specializing entirely in exports are afforded 'bonded' status, enabling them to bypass standard customs formalities and duty/tax exemption arrangements (in seven countries), followed by various instruments intended to extend application of the instruments to indirect exporters that supply locally produced inputs to exporters (six countries), by geographically delineated export processing zones (in five countries), and by the provision of bonded warehouses into which imports can be imported outside of standard customs procedures (in four countries). Geographically delineated export processing zones aside, the World Bank has actively promoted the establishment of these various instruments.

Administration of the instruments of trade neutrality presents three distinct organizational challenges. First, there is the challenge of providing the broadest possible access to the export instruments -- access for firms that produce for both the domestic and export markets as well as for specialized exporters, access to indirect (suppliers of inputs into export items) as well as direct exporters, and access for smaller and medium-sized as well as for large firms.

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[33] Institutional obstacles aside, many economists continue to acknowledge with varying degrees of enthusiasm the normative case for some protection against import competition. See, for example, Howard Pack and Larry E. Westphal, "Industrial Strategy and Technological Change", Journal of Development Economics, 1986; Alice Amsden, Asia's Next Giant: Late Industrialization in South Korea, 1989; Jeffrey Sachs, "Trade and Exchange Rate Policies in Growth-Oriented Adjustment Programs", Harvard University, mimeo, 1987; Dani Rodrik, "Liberalization, Sustainability, and the Design of Structural Adjustment Programs" The World Bank and Harvard University, January 1989; and Tyler Biggs and Brian Levy, "Strategic Interventions and the Political Economy of Industrial Policy in Developing Countries", in Dwight Perkins and Michael Roemer (eds.) Economic Systems Reform in Developing Countries (Harvard, forthcoming 1990). W. M. Corden, Trade Policy and Economic Welfare (Oxford: Clarendon Press, 1974) acknowledges that as a practical matter the second best case for import protection as a means of infant industry support is quite strong.

[34] It is noteworthy that Guinea and Ghana -- the two countries that have not put these instruments into place -- were identified in the previous section as the countries with the weakest organizational capability.

**TABLE 7: INSTRUMENTS OF EXPORT ADMINISTRATION IN SAMPLE COUNTRIES**

| | Export Processing Zones | Bonded Factories | Bonded Warehouses | Duty/Tax Drawbacks | Duty/Tax Exemption | Facilities for Indirect Export |
|---|---|---|---|---|---|---|
| Bangladesh | Yes (80s) | - | Yes | Yes (81) | Yes (83) | Yes (89) |
| amaica | Yes (82) | - | - | Yes (87) | - | - |
| Kenya | Yes (89) | Yes (83) | - | Yes (74) | - | - |
| Mauritius | - | Yes (70) | - | Yes (80s) | Yes (80s) | Yes (87) |
| exico | Yes (64) | Yes (83) | Yes (83) | Yes (71) | Yes (83) | Yes (86) |
| Morocco | - | Yes | - | Yes | Yes | Yes |
| Pakistan | - | Yes (86) | - | Yes (86) | - | Yes (86) |
| Philippines | Yes | - | Yes | Yes (81) | Yes | Yes (81) |
| Thailand | Yes (70s) | Yes (70s) | - | Yes (60s) | Yes (60s) | - |
| Tunisia | - | Yes (72) | Yes | Yes (71) | Yes (81) | - |
| Ghana | - | - | - | | | - |
| Guinea | - | - | - | | | - |

Second, there is the challenge of affording rapid service to firms -- of ensuring rapid access to requisite imported inputs, and (where relevant) of ensuring rapid reimbursement of duties or taxes. Third, there is the challenge of efficiently calibrating the neutrality instruments -- of ensuring that the instruments are used solely for the purposes intended, and (where relevant) of calibrating reimbursements to approximate closely the value of customs duties and indirect taxes paid for intermediate inputs embodied in final exports.

Setting aside for the moment how they are used in practice, even in principle the instruments vary in their abilities to meet the three challenges. While export processing zones and bonded factories can secure rapid, well-targeted duty and tax-free access to imported inputs for export firms, almost by definition they promote enclaves, excluding firms that partipate in both domestic and foreign markets. Conversely, while duty drawbacks and exemptions can in principle be utilized by a broad range of firms, their implementation requires a formidable administrative apparatus not only to process rapidly applications for drawbacks, but also to calculate the many thousand input-output coefficients[35] needed to compute accurately the appropriate magnitudes of duty and tax rebates.

Table 8 summarizes the limited available information as to experience with implementation of the instruments to secure trade neutrality.[36] Implementation of export processing zones and bonded factories appears to have proceeded quite smoothly in most countries for which information is available. As of 1985, 55 firms with exports valued at $416 million were located in export processing zones in the Philippines.[37] Net foreign exchange earnings in Jamaica's free zone rose from $1 million in 1982 to $32 million in 1987, and employment rose from under 1,000 to over 11,000.[38] In Mauritius, the expansion of manufactured exports from specialist export firms was rapid almost immediately after the establishment of the bonded factory/EPZ system in 1970, and accelerated again in the 1980s in response to a further round of adjustment policies; as of 1988 bonded factories accounted for 59% of export value and about 20% of Mauritius' employment.[39]

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[35] Rhee "Instruments for Export Policy" provides substantial detail as to how to administer duty drawback schemes.

[36] Unlike the policy reforms examined earlier, there is no clearly identifiable successful end-point against which progress in implementation can be guaged. Thus the categories for comparing country performance necessarily are different from those used earlier.

[37] The World Bank, The Philippines: Issues and Policies in the Industrial Sector, Report Number 6706-PH, July 30, 1987. There is some question, however, whether the economic benefits of the Philippines zones are larger than the economic costs, given the high costs (compounded in at least one case by inappropriate location) of the infrastructure needed to establish the zones.

[38] The World Bank, Jamaica: Adjustment under Changing Economic Conditions, Report No. 7753-JM, April 26, 1989, p. 15

[39] Data provided by Professor E.L.M. Lim Fat in a seminar on 19 September, 1989 at the IFC; see also E.L.M. Lim Fat "The Mauritius Export Processing Zone" paper presented at Enterprise Symposium, UNCTAD VII, Geneva, July 1987. Mauritius' Export Zone is in fact an administrative category that extends island-wide; hence its depiction here as a bonded factory system.

**TABLE 8: ADMINISTRATIVE EXPERIENCE WITH IMPLEMENTATION OF INSTRUMENTS OF EXPORT ADMINISTRATION**

| | Export Processing Zones | Bonded Factories | Bonded Warehouses | Duty/Tax Drawbacks | Duty/Tax Exemption |
|---|---|---|---|---|---|
| Bangladesh | Start-up difficulties | | Good | Week | Weak |
| Jamaica | Good after initial difficulties | | | Weak | |
| Kenya | Too soon to tell | Weak | | Too soon to tell | |
| Mauritius | | Good | | Weak | Moderate |
| Mexico | Good | Moderate | | Weak | Moderate |
| Morocco | | | | | Good |
| Pakistan | | Too soon to tell | | Weak, prior to 1986 | |
| Philippines | Good | | Good | Weak | Weak |
| Thailand | | Good | | Improves over time; good by 1988 | |
| Tunisia | | Good | | Weak | Weak |

Mexico's border industry program was established in 1964, but took off only after that country's massive 1982 devaluation; by 1987 Mexico's maquiladora program employed almost 400,000 people and accounted for 5.7% of export revenues.[40] In Tunisia, a 1972 reform permitting bonded factories laid the foundation for a 14% annual real increase in manufactures exports over the next decade. However, the Mexican, Jamaican, Philippine and Tunisian arrangements operate essentially as enclaves isolated from manufacturers producing for the domestic market.[41]

Table 8 points to rather more variation among countries in experience with bonded warehouse and duty/tax drawback or exemption schemes (most of the schemes to support indirect exports are of too recent duration for useful information on implementation to have emerged; a priori, their experience is likely to correspond closely with -- or be somewhat worse than -- the broader experience with drawback or exemption schemes). The Philippines bonded warehouse scheme appears to have worked well, especially for garments and textiles firms who in 1985 channelled $619 million of exports through these arrangements; by contrast, drawback and exemption schemes became mired in excessive and discretionary bureaucratic procedures, and afforded firms only $12 million in customs and tax rebates in 1985.[42] Similarly, bonded warehouses for Bangladeshi garment exporters have operated successfully; although the Bangladeshi government continues to work to improve performance,[43] experience with other instruments thus far has been less satisfactory. Kenya's bonded manufacturing scheme has not got off the ground, mired in an administrative swamp throughout the five years since it first was announced; similarly, only forty companies regularly take advantage of Kenya's duty drawback scheme, even though it has been in place for over ten years.[44]

Among the remaining countries, in Thailand implementation of drawback and exemption schemes appears to have improved continually over time, with the ratio between

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[40] But note that according to data from The World Bank, Mexico: Trade Policy Reform and Economic Adjustment, August 23, 1988 p. 55, maquila exports were only one-sixth as large as total Mexican manufactures exports; Joseph Grunwald, "Technology Transfer and Assembly Industries" draft May 1989 evaluates quite positively the developmental contribution to Mexico of the maquila factories.

[41] Although the Mauritius scheme is also solely for 100% exporters, it is difficult to describe as an enclave an arrangement that employs 20% of a nation's work force.

[42] The World Bank, The Philippines: Issues and Policies in the Industrial Sector. It is interesting to note that the administration of bonded warehouses for garments and textile (but not other) exports is handled by the Garments and Textiles Export Board, an agency independent of the Philippines Bureau of Customs. The garment and textile facility handled almost three times the value of imports, and five times the number of firms as did the Customs bureau.

[43] The World Bank, Bangladesh: Export Development Project, Report Number 7368-BD, March 22, 1989, pp. 6-8.

[44] The World Bank, Industrial Sector Adjustment Credit: President's Report, May 24, 1988; also The World Bank, Kenya: Industrial Sector Policies for Investment and Export Growth, Report Number 6711-KE, June 30, 1987, p.38.

duties returned to firms (via drawback or exemption) and actual duty collection rising from 25% in 1983 to 60% in 1987.[45] In both Mauritius and Mexico, exemption schemes have been significantly more successful than drawback arrangements. Mauritius' duty exemption scheme is used by relatively large firms that produce regularly for both domestic and import markets; the drawback scheme, which involves cumbersome procedures and significant delays prior to repayment, is used by few manufacturers. In Mexico, imports valuing $2.8 billion were processed in 1987 via that country's temporary import duty exemption scheme, while the duty drawback scheme was used for only $200 million of imports; the coverage of both schemes was narrow, with only 463 firms taking advantage of the temporary admissions, and 186 firms the duty drawback, schemes.[46] Morocco's temporary admissions scheme (a duty exemption scheme in the nomenclature used here) apparently has worked well, with continual reduction in the bureaucratic requirements and processing time associated with gaining access to duty-free imports by exporters.[47] As for Jamaica, Pakistan and Tunisia, the limited evidence available suggests that administrative sluggishness in responding to applications and difficulties in managing the array of input-output coefficients have severely circumscribed the utility to putative exporters of drawback and exemption schemes.

Two patterns emerge from this review of experience. First, enclave arrangements such as bonded factories and export processing zones appear to be the most readily implementable of the trade neutrality schemes. However, insofar as enclaves separate exporters from the domestic economy, these schemes seem to do relatively little to diffuse more broadly the positive learning externalities associated with exports or to broaden the constituency for further liberal reform. Second, countries with sufficiently strong organizational capabilities appear able to make effective use of drawback and exemption schemes,[48] thereby capturing many of the benefits associated with exports and sustaining the transition to a liberal policy environment.

## IV. ANALYSIS AND IMPLICATIONS OF COUNTRY EXPERIENCE

Two tasks remain for this final section of the paper. The first task is to lay out some general propositions that account for the variations among countries and policies in the

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[45] Additional tax exemptions provided to firms promoted by the Board of Investment amounted to more than 120% of duty collected on intermediates and raw materials. Data are from The World Bank, Thailand: Country Economic Memorandum, 1989 p. 63.

[46] Details are from The World Bank, Mexico: Trade Policy Reform and Economic Adjustment, 1988, p. 69. According to that report, there are several thousand exporting firms (excluding the maquilas) in Mexico, with the 600 largest accounting for less than 60% of total non-oil exports.

[47] For this judgement, see The World Bank Morocco: The Impact of Liberalization, Report No. 6714-MOR, March 15, 1988, p. 25.

[48] Along with the countries discussed in the text, both Taiwan and especially Korea made extensive use of duty drawback and exemption schemes for direct as well as indirect exporters in the course of their successful efforts at outward-oriented industrial development.

scope, adoption and implementation of policy reform; given the relatively small number of observations and the non-random character of the sample, these propositions necessarily are tentative. The second task is to delineate the operational implications of these propositions for the design of trade and investment policy reform.

Accounting for the Patterns

As explained earlier, policy changes were disaggregated along the dimensions of scope, adoption and implementation as an initial way to distinguish between political and organizational obstacles to reform: limitations in scope and adoption can straightforwardly be attributed to political obstacles, while organizational obstacles emerge disproportionately in implementation (although note that implementation problems can have political as well as organizational origins).

This subsection makes use of these distinctions to analyze first variations among policy reforms in the magnitude of their organizational requirements, thereafter variations among countries in their organizational capabilities, and finally variations among countries in political obstacles to reform.

The organizational-intensity of policy reform. Tables 8 and 9 together point to some systematic variations among policies in the extent of problems associated with implementation.

As Table 9 summarizes, implementation was an obstacle in only 1 (3 if Kenya and Guinea's experiences with QR reform are included; both fell short of full achievement but made significant progress) of 23 instances of trade policy reform, but in 2 of 7 (11 if countries with free entry prior to reform are included in the sample) instances of reform of regulatory obstacles to entry, and in 3 (5 if Thailand and Tunisia are included; both fell short of full achievement but made significant progress) of 9 instances of investment incentive reform. A parallel contrast is evident in Table 8, with good implementation in 8 of the 11 instances to establish export processing zones, bonded factories and bonded warehouses for which information is available, but weak implementation in 10 of the 15 efforts to set up duty and tax drawback or exemption schemes; within the last category, implementation was more successful for exemption than for drawback schemes. Three propositions help account for these variations in implementation and in associated organizational obstacles.

First, the task of dismantling policies inimical to efficient economic growth appears to be relatively simple organizationally. This is not always evident in World Bank assessments of experience only because political obstacles often are not distinguished from organizational problems. The elimination of quantitative restrictions and the abolition (as opposed to streamlining) of bureaucratic prerequisites to entry pose essentially a negative challenge for bureaucracies -- to refrain from actions that had hitherto been part of their organizational function. Similarly, the implementation (as opposed to planning) of tariff reform also requires relatively little of organizations; it requires no changes in organizational behavior, merely changes in the numerical values associated with routine operations. Guinea aside, the empirical review of experience with these three reforms uncovered almost no evidence of difficulties in implementation -- although there remains the risk that where disabling policies were dismantled but implementing organizations left otherwise untouched, the implementing organizations will over time uncover roundabout mechanisms for reasserting their authority.

**TABLE 9: VARIATIONS BY POLICY IN EXTENT OF REFORM**

| | Number of Countries with Limited/Moderate Scope or Adoption | Number of Countries with Limited Progress in Implementation | Number of Countries with at Least Extensive Scope & Significant Progess in Adoption and Implementation |
|---|---|---|---|
| Removal of QR's | 6 | 0 (2) | 7 |
| Tariff Reform | 4 | 1 | 6 |
| Reform of Entry Regulations | 3 | 2 | 3 (7) [1/] |
| Reform of Investment Incentives | 3 | 3 (5) [1/] | 3 (1) [1/] |
| TOTAL | 16 | 6 | 19 |

[1/] Bracketed figures are explained in the text.

As the experience with SECOFI in Mexico revealed, securing forebearance can sometimes be politically challenging; but given the political capacity of government leadership to impose its will, there appear to be only limited organizational obstacles to dismantling disabling policies.

Second, the results bear out what one might expect: it is more demanding organizationally to reorient existing institutions than to dismantle them. Where reforms involve the establishment of 'one-stop shops' for new entrants or the streamlining of investment incentives, investment agencies are expected to alter the criteria used to evaluate applications, to accelerate the application process, and more broadly to shift from a bureaucratic to a supportive mode of operation in relation to the private sector. Where reforms involve the establishment of duty/tax drawback and exemption schemes it is customs and fiscal agencies that need to reform their organizational procedures. Only Morocco and Thailand (and also, to a lesser degree, Mauritius and Mexico) succeeded in putting in place effective drawback and exemption schemes; and none of the countries analyzed were successful in reorienting investment agencies (although the record in Tunisia is the least unfavorable). The contrast between Mauritius' and Mexico's experience with investment reform and that of other countries illustrates the general proposition. Only in Mexico and Mauritius did the implementation of investment incentive reform proceed smoothly; and only in these two countries did investment reform involve the abolition of investment incentives, not an effort to streamline them. Similarly, entry liberalization proceeded smoothly in Bangladesh, Pakistan and Tunisia where bureaucratic prerequisites were eliminated, but became bogged down in Ghana where they were streamlined.

Third, not surprisingly it is organizationally easier to establish administrative enclaves than it is to reform more broadly the existing bureaucracy. Thus enclave arrangements such as bonded factories and export processing zones appear to be the most readily implementable of the trade neutrality schemes, most likely precisely because they are enclaves and hence can be administered entirely separately from the wider bureaucratic apparatus of government. Along the same lines, in both Bangladesh and the Philippines, bonded manufacturing warehouses were successful where they were run by independent agencies set up to serve the garment and textile export industries, but were less successful where they were part of the general customs administration.

Variations among countries in organizational capabilities. Tables 8 and 10 together point to some variations among countries in the extent of implementation difficulties and associated organizational capabilities.

Among the sample countries, organizational capacity appears to be greatest for Morocco, Thailand, Mexico and Mauritius, and weakest for Ghana and Guinea, with the remaining six countries in between. The four organizationally well-endowed countries not only implemented relatively smoothly their reforms to promote domestic and import competition, all four also operated highly successful enclaves for exporters, and managed drawback/exemption schemes with at least moderate success. By contrast, neither Guinea nor Ghana attempted to put in place instruments to secure trade neutrality; further, both countries experienced problems with implementation of the organizationally straightforward task of dismantling institutions inimical to economic growth.

The example of Guinea illustrates with special vividness the nature and origins of the organizational shortfalls.[49] Guinea was the only country in the sample where implementation problems systematically undermined efforts to dismantle the disabling environment across the entire range of policies. These difficulties in implementation reflect the extreme degradation of the bureaucratic structure inherited by a new government which came to power in 1985 after 25 years of rule by President Sekou Toure. By all accounts the degree of decomposition of government authority over the bureaucracy was substantially greater than for any of the other countries of the sample: lacking newspapers, or gazettes publishing government laws and decrees, there were no effective channels of communication within the government or between the government and the general public; official salaries were minimal, yet there was enormous padding of the number of bureaucratic functionaries formally vested with some kind of official authority; many bureaucrats were illiterate, many had no offices, let alone office supplies. With the bureaucratic apparatus in an advanced state of decomposition, notwithstanding an apparently unequivocal commitment to economic adjustment, the new regime was unable to control the anarchically decentralized obstruction of reform described earlier for the various policies. Hence the Guinean failure to manage the implementation even of policies which, as outlined above, posed relatively modest organizational challenges.[50]

<u>Variations among countries in political obstacles to reform</u>. Tables 9 and 10 suggest that political obstacles have been rather more important in inhibiting import liberalization and the liberalization of domestic competition[51] than have organizational limitations. While reform proceeded smoothly in only 18 of 40[52] cases, implementation problems inhibited change in just 6 (9 if significant progress in implementation is interpreted to be a problem) of the 22 examples where adjustment ran into difficulties; obstacles associated with limitations in scope and adoption (presumably reflecting political constraints on reform) were a problem in 17 instances.

Disaggregating among countries, table 10 points to significant cross-country variations in the extent of political obstacles to trade and investment policy reform.

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[49] For a review of institutional shortcomings in Ghana, see Samuel Paul, "Private Sector Assessment: A Pilot Exercise in Ghana", The World Bank, Policy Planning and Research, Working Paper Number 199, May 1989.

[50] Note, though, the alternative possibility that even Guinea's problems had a significant political component. Political problems might have surfaced at the implementation stage rather than earlier insofar as Guinea had no alternative other than to go along with the World Bank as a way of gaining access to desperately needed foreign exchange.

[51] As noted earlier, the establishment of instruments to secure trade neutrality poses few political problems insofar as it does not threaten with losses any powerful interests within the government bureaucracy or society more broadly.

[52] Entry liberalization in Ghana was both limited in scope and had only limited progress in implementation; thus this reform is included in two columns in Tables 9 and 10.

## TABLE 10: VARIATIONS BY COUNTRY IN EXTENT OF REFORM

| | Number of Policies with at Least Extensive Scope and Significant Progress in Adoption and Implementation [1] | | Number of Policies with Limited/Moderate Scope or Limited Progress in Adoption | Number of Policies with Limited Progress in Implementation |
|---|---|---|---|---|
| Guinea | 1 | (1) | 0 | 3 |
| Ghana | 2 | (2) | 1 | 2 |
| Mexico | 3 | (2) | 1 | 0 |
| Morocco | 2 | (2) | 0 | 0 |
| Tunisia | 3 | (1) | 1 | 0 |
| Mauritius | 2 | (1) | 1 | 0 |
| Pakistan | 1 | (0) | 3 | 0 |
| Bangladesh | 1 | (0) | 3 | 0 |
| Kenya | 1 | (1) | 3 | 0 |
| Philippines | 1 | (1) | 1 | 1 |
| Thailand | 1 | (1) | 2 | 0 |
| Jamaica | 1 | (1) | 0 | 0 |
| TOTAL | 18 | | 17 | 6 |

[1] The bracketed figures signify the number of import liberalization policies in this category

The differences are especially striking between Mexico, Tunisia, Guinea and Ghana on the one hand, and Kenya, Pakistan and Bangladesh on the other: the former group of countries adopted broad reforms in at least three of the four policies (though Guinea ran into difficulties in implementing most of these reforms); in the latter group by contrast, scope was limited or moderate, or progress in adoption limited, for at least three of the four policies.

A thorough accounting of the reasons for these differences would require analyses of the political economy of ch nation that extend well beyond the reach of the present paper. However, the patterns appear consistent with a central conclusion of a recent comparative volume of the politics of adjustment in thirteen developing countries edited by Joan Nelson.[53] According to that study, successful reformers shared two core features that were absent to some degree in countries where reform lagged:

> "the widespread perception of the need for far-reaching reforms (resulting from a legacy of economic decline and political decay or acute challenge) and an executive empowered by some combination of established political institutions and more transient circumstances with an unusual concentration of authority."[54]

Notwithstanding its overall consistency with the results summarized in this paper,[55] Nelson's conclusion fails to account for observed differences among the sample countries in the relative magnitudes of trade and investment reforms: Mexico, Morocco and Ghana achieved significantly greater success in liberalizing imports -- via both the elimination of quantitative restrictions and tariff reforms -- than they did in liberalizing domestic competition; by contrast the reform of the environment for domestic competition went further than did import liberalization in Tunisia, Bangladesh and Pakistan. While more research as to the reasons for these differences is needed, potential explanations include variations among countries in the extent to which domestic regulation functioned as a mechanism of political control (or rent-seeking), variations among countries in the political influence of domestic industry (including state-owned enterprises) and factory workers and in the associated

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[53]. Joan Nelson (ed.) Economic Crisis and Policy Choice: The Politics of Adjustment in Developing Countries (Princeton: Princeton University Press, 1989). The countries analyzed in the volume are Argentina, Brazil, Mexico, Chile, Peru, Colombia, Costa Rica, the Dominican Republic, Jamaica, Ghana, Zambia and Nigeria.

[54] Joan Nelson, "Introduction" in Nelson (ed.) Economic Crisis and Policy Choice, pp. 44-45 draft manuscript.

[55] Among the countries included in the present analysis that adopted broad reforms, Mexico and Ghana were included in the analyses that led to the conclusion quoted above; at least in some degree, Tunisia shares the two core features identified by Nelson of widespread perception of the need for far-reaching reforms and strong executive authority; and Guinea's post-1985 military government had far-reaching powers, at least formally. As for the cases of half-hearted reform, along with the Philippines (analyzed directly in the volume), the Kenyan experience also appears consistent with Nelson's conclusion insofar as the well-documented importance in that nation of regional and ethnic patronage as a mechanism of political control constrains substantially the autonomy of that nation's executive.

willingness of governments to expose them to import competition, and variations among countries in the agendas for reform of international donor agencies.

Implications for the Design of Trade and Investment Policy Reform

There are three different approaches to incorporating the institutional considerations that have been the focus of the present paper in the design of structural adjustment lending. The first is to ignore them entirely, and design programs on the assumption that public organizational capabilities and the political commitment to reform will be forthcoming; as should be obvious from this paper, the policy changes actually implemented via that approach, and the subsequent economic responses, are likely to be quite different from the initial intentions of the reformers.

The second approach is to acknowledge the reality of institutional constraints but to include them more or less as an afterthought, earmarking technical assistance for weak institutions only after the reform package has been designed on the basis of other considerations. This approach clearly is preferable to ignoring entirely institutional capabilities. Even so, its potential is limited insofar as it leaves entirely unaddressed problems posed by political obstacles to reform, and presumes (optimistically) that technical assistance will be sufficient to enhance organizational capability even in the short-term.

The third approach is to bring institutional considerations to center stage, designing and sequencing programs in ways that are consistent with the capabilities of the reforming nation. Ex ante assessments of organizational capabilities within the public sector, and of the political preferences and room to manoeuvre of the national leadership are crucial inputs in any such effort. Although a body of knowledge is emerging as to how to proceeed with political and organizational assessments,[56] the present paper has focused rather on ex post evaluation of political and organizational obstacles as a way of clarifying concretely how programs to reform trade and investment policy might usefully be matched to country capabilities. The analysis has highlighted variations among policies in their organizational and political requirements, and variations among countries in their organizational capabilities and political commitments to change. These variations point to significant differences among countries in the potential for -- and appropriate sequence of -- policy reform. Specifically, while the prospects for policy reform are nil where both the political commitment to pursue reform and the organizational capacity to effect reform are absent, reform might usefully be pursued where one of these two institutional foundations for change is in place. However, the preferred reform strategy will vary with the balance prevailing in any individual country between political commitment and organizational capability.

Consider first countries with substantial political commitment to reform but only

[56] For an overview of the relevant components of institutional assessments, see two papers by Samuel Paul "Institutional Diagnosis in World Bank Projects", CECPS, draft, June 2, 1989 and "Institutional Development at the Sectoral Level: A Cross-sectoral Review of Bank Projects", CECPS, draft, November 15, 1989. A recent political assessment of the opportunities and constraints of reform in Algeria prepared by a consultant for the EMENA region -- Vedat Milor, "Algeria: A Country at the Crossroads", draft, June 30, 1988 -- has apparently proven useful in the formulation of a reform program for that country.

weak organizational capabilities. Among those analyzed here, Ghana and Guinea fit most closely into this category; the category also fits other countries in Sub-Saharan Africa quite well. Reform in these countries should give special emphasis to the dismantling -- not reorientation -- of disabling policies, institutions and regulations. Free entry for firms should be favored over the establishment of one-stop shops to streamline the bureaucratic process; special incentives for selected industries should be abolished, not rewritten to favor socially efficient subsidization; import liberalization should be pursued to the maximum extent possible, not finessed via the promotion of instruments of trade neutrality.

Radical measures of this kind are called for not because wholesale dismantling necessarily represents the optimum optimorum, but because it is the only plausible way of effecting real change in the face of pervasive organizational rigidities. Even after the dismantling effort has proceeded to the maximum extent possible, the risk remains that the combination of organizational sclerosis and a weak private sector will inhibit a supply response. Given this risk, it is hardly surprising that many countries with weak public and private institutions are exceedingly reluctant to push ahead with liberal economic reforms. But if the analysis in this paper is correct, countries with substantial political autonomy but limited organizational capability have no middle course, no realistic alternative but to choose between the certainty of continued stagnation without reform, or non-incremental shrinkage in the size and role of government, a shrinkage that in the short- and medium-term may go unrewarded by a positive supply response. In these countries, World Bank adjustment programs that promote organizationally-demanding reforms complemented by resources for organizational development are likely to be of limited usefulness.

The desirable strategy for sequencing reform is quite different -- and the initial choices significantly less stark -- for countries with strong organizational capabilities but only limited political flexibility or commitment to effect reform. Even in response to compelling economic analysis, such countries are unlikely to dismantle existing policies -- import restrictions, restrictions on domestic competition, regulatory prerogatives of government bureaucrats and the like -- in ways that challenge existing interests.[57] So the task for these nations is to use their organizational strengths to provide export opportunities to efficient firms in ways that strengthen the constituency for further reform, without challenging head-on the interests that benefit most from inefficient policies. The sequence of reforms in both Mauritius and Thailand, the two development successes of the 1980s included in the sample is consistent with such a strategy:[58] in both countries the establishment of instruments of trade neutrality to support exporters preceded by some years efforts at import liberalization. The implication follows that, at least in the initial period of reform, the World Bank might do well to focus policy dialogue on export promotion and ease pressure to liberalize imports in countries with

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[57] Although note that some organizationally strong countries may be able to dismantle obstacles to domestic but not import competition, and other countries the reverse. It is unambiguously desirable to proceed with dismantling obstacles to domestic competition. However, insofar as domestic rigidities inhibit adjustment to increased import competition, countries have the option of using their administrative capabilities to promote exports without dismantling entirely the obstacles to import competition.

[58] Both Korea and Taiwan also followed the sequence of export first, liberalize imports later.

limited political flexibility but substantial organizational capability.[59]

A more difficult choice emerges for countries with moderate organizational capabilities within the public sector. The risk here is that efforts to promote exports will fail to yield much success in the face of administrative limitations, but will nonetheless substitute for other, politically more difficult, reforms. In such countries, the case might be strong for technical assistance targeted to strengthen the capability of the institutions that manage the instruments of trade neutrality. As analyzed earlier, the organizational task is likely to be simpler where the relevant agencies can be set up as enclaves, operating entirely separately from the wider bureaucratic apparatus of government. Consistent with this roundabout strategy is the recent establishment of a system of bonded factories in Kenya (and earlier enclave efforts in Tunisia and the Philippines). However, instruments of trade neutrality can help sustain the dynamic of reform only if they extend opportunities for participation in export markets beyond specialist exporters to both indirect exporters and firms that produce for protected domestic markets; it remains unclear whether administrative enclaves can be organized in ways that reach this broad range of firms.[60]

Finally, there are countries favored with both the organizational capability and the political flexibility and commitment to effect reform. Such countries face no institutional obstacles to pursuing the liberal policies of reform promoted by the World Bank. But they can equally readily move forward with roundabout policies that make intensive use of the instruments of trade neutrality as well as other administration-intensive measures to induce firms to export. As the successful East Asian examples of development reveal, these latter policies -- though illiberal in the short-term -- can be highly effective in promoting dynamically efficient economic development.

[59] The experience summarized in The World Bank, "Strengthening Trade Policy Reform", Trade Policy Division, Country Economics Department, PPR, October 1989 suggests that in many instances the Bank has indeed been sensitive to the advantages of 'export-first' sequencing.

[60] The positive experience with bonded warehouses for garment and textile firms in both the Philippines and Bangladesh affords some grounds for optimism.

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